SYNOPSYS INC
Form 10-Q
August 26, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JULY 31, 2014
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER: 0-19807

SYNOPSYS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	56-1546236
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

700 EAST MIDDLEFIELD ROAD
MOUNTAIN VIEW, CA 94043
(Address of principal executive offices, including zip code)
(650) 584-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (l) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	ý	Accelerated Filer	¨
Non-accelerated filer	¨ (Do not check if smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of August 22, 2014, there were 155,825,554 shares of the registrant's common stock outstanding.

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FOR THE FISCAL QUARTER ENDED JULY 31, 2014
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value amounts)

	July 31, 2014	October 31, 2013*
ASSETS		
Current assets:		
Cash and cash equivalents	$903,046	$1,022,441
Accounts receivable, net	238,863	256,026
Deferred income taxes	99,217	92,058
Income taxes receivable and prepaid taxes	18,544	18,277
Prepaid and other current assets	55,113	59,175
Total current assets	1,314,783	1,447,977
Property and equipment, net	216,010	197,600
Goodwill	2,260,897	1,975,971
Intangible assets, net	367,416	335,425
Long-term prepaid taxes	9,952	7,935
Long-term deferred income taxes	204,502	243,066
Other long-term assets	171,369	150,961
Total assets	$4,544,929	$4,358,935
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$319,036	$358,197
Accrued income taxes	20,716	7,168
Deferred revenue	857,532	827,554
Short-term debt	30,000	30,000
Total current liabilities	1,227,284	1,222,919
Long-term accrued income taxes	37,030	53,064
Long-term deferred revenue	67,311	54,736
Long-term debt	52,500	75,000
Other long-term liabilities	164,751	164,939
Total liabilities	1,548,876	1,570,658
Stockholders' equity:		
Preferred Stock, $0.01 par value: 2,000 shares authorized; none outstanding	—	—
Common Stock, $0.01 par value: 400,000 shares authorized; 155,638 and 154,169 shares outstanding, respectively	1,556	1,542
Capital in excess of par value	1,594,965	1,597,244
Retained earnings	1,501,238	1,324,854
Treasury stock, at cost: 1,626 and 3,095 shares, respectively	(60,194)	(106,668)
Accumulated other comprehensive income (loss)	(41,512)	(28,695)
Total stockholders' equity	2,996,053	2,788,277
Total liabilities and stockholders' equity	$4,544,929	$4,358,935

* Derived from audited financial statements.
See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
Revenue:				
Time-based license	$431,184	$387,088	$1,255,515	$1,186,538
Upfront license	31,594	39,957	101,863	95,525
Maintenance and service	59,034	55,900	161,082	175,276
Total revenue	521,812	482,945	1,518,460	1,457,339
Cost of revenue:				
License	68,573	69,857	198,700	195,918
Maintenance and service	20,685	19,253	62,065	59,074
Amortization of intangible assets	26,272	26,537	74,699	79,451
Total cost of revenue	115,530	115,647	335,464	334,443
Gross margin	406,282	367,298	1,182,996	1,122,896
Operating expenses:				
Research and development	182,809	166,668	528,395	494,140
Sales and marketing	112,271	105,381	332,847	311,069
General and administrative	37,438	34,510	112,246	104,702
Amortization of intangible assets	6,537	5,744	18,291	17,506
Total operating expenses	339,055	312,303	991,779	927,417
Operating income	67,227	54,995	191,217	195,479
Other income (expense), net	3,544	3,177	18,797	21,130
Income before provision for income taxes	70,771	58,172	210,014	216,609
Provision (benefit) for income taxes	5,115	5,875	13,345	25,699
Net income	$65,656	$52,297	$196,669	$190,910
Net income per share:				
Basic	$0.42	$0.34	$1.27	$1.25
Diluted	$0.42	$0.33	$1.25	$1.22
Shares used in computing per share amounts:				
Basic	155,194	153,915	154,611	152,969
Diluted	157,622	157,056	157,253	156,215

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Net income	$65,656	$52,297	$196,669	$190,910
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	1,713	(6,234)	(9,502)	(20,746)
Cash flow hedges:				
Deferred gains (losses), net of tax of $311 and $502, for the three and nine months ended July 31, 2014, respectively, and of $804 and $3,336 for each of the same periods in fiscal 2013, respectively	(831)	(2,189)	1,658	1,507
Reclassification adjustment on deferred (gains) losses included in net income, net of tax of $(205) and $(1,784), for the three and nine months ended July 31, 2014, respectively, and of $601 and $401 for each of the same periods in fiscal 2013, respectively	(2,540)	(3,741)	(4,973)	(5,471)
Other comprehensive income (loss), net of tax effects	(1,658)	(12,164)	(12,817)	(24,710)
Comprehensive income	$63,998	$40,133	$183,852	$166,200

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended July 31,	
	2014	2013
Cash flow from operating activities:		
Net income	$196,669	$190,910
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization and depreciation	140,750	141,756
Stock compensation	58,341	49,719
Allowance for doubtful accounts	(750)	901
Deferred income taxes	7,459	7,272
Loss (gain) on sale of investments	(6,538)	(101)
Net changes in operating assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	24,834	8,207
Prepaid and other current assets	982	(14,617)
Other long-term assets	(18,847)	(20,292)
Accounts payable and other liabilities	(28,270)	(48,188)
Income taxes	(18,950)	(475)
Deferred revenue	22,361	(9,722)
Net cash provided by operating activities	378,041	305,370
Cash flows from investing activities:		
Proceeds from sales of long-term investments	7,313	222
Proceeds from sale of property and equipment	—	2,000
Purchases of property and equipment	(58,085)	(47,624)
Cash paid for acquisitions and intangible assets, net of cash acquired	(373,513)	—
Capitalization of software development costs	(2,812)	(2,681)
Other	(3,000)	—
Net cash used in investing activities	(430,097)	(48,083)
Cash flows from financing activities:		
Proceeds from credit facility	200,000	—
Repayment of debt	(223,239)	(22,975)
Acquisition of non-controlling interests	—	(44,004)
Issuances of common stock	45,336	90,529
Purchases of treasury stock	(79,747)	(69,999)
Other	(5,008)	(5,781)
Net cash used in financing activities	(62,658)	(52,230)
Effect of exchange rate changes on cash and cash equivalents	(4,681)	(13,069)
Net change in cash and cash equivalents	(119,395)	191,988
Cash and cash equivalents, beginning of year	1,022,441	700,382
Cash and cash equivalents, end of period	$903,046	$892,370

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Description of Business

Synopsys, Inc. (Synopsys or the Company) is a world leader in supplying the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. The Company also offers intellectual property (IP) products, which are pre-designed circuits that engineers use as components of larger chip designs rather than designing those circuits themselves. The Company provides software and hardware used to develop the systems that incorporate chips and the software that runs on them. To complement these product offerings, the Company provides technical services to support these solutions and helps its customers develop chips and electronic systems. The Company is also a leading provider of software tools that developers use to improve the quality and time-to-market of software code in a wide variety of industries, including electronics, financial services, energy, and industrials.

Note 2. Summary of Significant Accounting Policies

The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP). In management’s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its unaudited condensed consolidated balance sheets, results of operations, comprehensive income and cash flows. The Company’s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in Synopsys’ Annual Report on Form 10-K for the fiscal year ended October 31, 2013 as filed with the SEC on December 20, 2013.

Use of Estimates. To prepare financial statements in conformity with GAAP, management must make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ from these estimates and may result in material effects on the Company’s operating results and financial position.

Principles of Consolidation. The unaudited condensed consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Fiscal Year End. The Company’s fiscal year generally ends on the Saturday nearest to October 31 and consists of 52 weeks, with the exception that approximately every five years, the Company has a 53-week year. When a 53-week year occurs, the Company includes the additional week in the first quarter to realign fiscal quarters with calendar quarters. Fiscal 2014 and 2013 are both 52-week years. The third fiscal quarters, and first nine months, of fiscal 2014 and 2013 ended on August 2, 2014 and August 3, 2013, respectively. For presentation purposes, the unaudited condensed consolidated financial statements and accompanying notes refer to the closest calendar month end.

Subsequent Events. The Company has evaluated subsequent events through the date that these unaudited condensed consolidated financial statements were issued.

Note 3. Business Combinations

During fiscal 2014, the Company made several acquisitions that were accounted for as business combinations. The Company does not consider these acquisitions to be material, individually or in the aggregate, to the Company’s balance sheet and results of operations. The consolidated financial statements include the operating results of each acquired business from the respective date of acquisition.

Acquisition of Coverity, Inc. (Coverity)

On March 24, 2014, the Company acquired Coverity, the leading provider of software quality, testing and security tools, for $375.5 million in cash, payable to holders of Coverity capital stock and vested stock options. Additionally, the Company assumed outstanding unvested Coverity stock options. The Company believes this

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acquisition has enabled it to enter into a new, growing market dedicated to helping companies deliver better software faster, by finding software code defects as the code is being developed rather than at the end of the process. Coverity's customer base includes Synopsys' semiconductor and systems customers, albeit different users and budgets, and extends well beyond to software developers such as independent software vendors and companies engaged in e-commerce.

The total purchase consideration and the preliminary purchase price allocation were as follows:

	(in thousands)
Total cash consideration	$375,500
Goodwill	$266,423
Identifiable intangibles assets acquired	101,900
Other tangible assets acquired, net	28,447
Deferred revenue	(21,270)
Total purchase price allocation	$375,500

As of the end of the third quarter of fiscal 2014, the Company's purchase price allocation is preliminary and has not been finalized. The acquired gross deferred revenue amount of $68.5 million was recorded at fair value of $21.3 million as required by accounting rules. Goodwill of $266.4 million, which is not deductible for tax purposes, primarily resulted from the Company's assembled workforce and expectation of sales growth due to its entrance into a new market and its new technology offerings. Acquired identifiable intangible assets of $101.9 million, consisting of technology, customer relationships, in-process R&D, backlog and trademarks, were valued using the income method, and are being amortized over two to eight years. The fair value of stock options assumed was approximately $15.0 million using the Black-Scholes option-pricing model and are expensed over their remaining service periods on a straight-line basis.

Other Fiscal 2014 Acquisitions

During the nine months ended July 31, 2014, the Company acquired three other companies for cash and preliminarily allocated the total purchase consideration of $40.3 million to the assets acquired and liabilities assumed based on their respective fair values at the acquisition dates, resulting in total goodwill of $24.1 million, which is not deductible for tax purposes. Acquired identifiable intangible assets totaling $22.3 million were valued using the income or cost methods and are being amortized over their respective useful lives ranging from two to eight years.

The preliminary fair value estimates for the assets acquired and liabilities assumed for these acquisitions are not yet finalized and may change as additional information becomes available during the respective measurement periods. The primary areas of those preliminary estimates relate to certain tangible assets and liabilities, identifiable intangible assets, and taxes. Additional information, which existed as of the acquisition date but is yet unknown to the Company, may become known to the Company during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. Changes to amounts recorded as assets or liabilities will be recorded as retrospective adjustments to the provisional amounts recognized as of the acquisition date and may result in a corresponding adjustment to goodwill.

Note 4. Goodwill and Intangible Assets

Goodwill as of July 31, 2014 consisted of the following:

	(in thousands)
As of October 31, 2013	$1,975,971
Additions	290,476
Effect of foreign currency translation	(5,550)
As of July 31, 2014	$2,260,897

Intangible assets as of July 31, 2014 consisted of the following:

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	Gross Assets	Accumulated Amortization	Net Assets
	(in thousands)		
Core/developed technology	$459,147	$279,995	$179,152
Customer relationships	210,292	86,370	123,922
Contract rights intangible	146,842	101,481	45,361
Covenants not to compete	2,530	2,530	—
Trademarks and trade names	18,779	7,056	11,723
In-process research and development (IPR&D)(1)	3,087	—	3,087
Capitalized software development costs	21,003	16,832	4,171
Total	$861,680	$494,264	$367,416

(1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment.

Intangible assets as of October 31, 2013 consisted of the following:

	Gross Assets	Accumulated Amortization	Net Assets
	(in thousands)		
Core/developed technology	$380,724	$228,065	$152,659
Customer relationships	177,151	69,745	107,406
Contract rights intangible	140,517	78,950	61,567
Covenants not to compete	2,530	2,480	50
Trademarks and trade names	10,891	5,459	5,432
In-process research and development (IPR&D)(1)	4,298	—	4,298
Capitalized software development costs	18,190	14,177	4,013
Total	$734,301	$398,876	$335,425

(1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment.

Amortization expense related to intangible assets consisted of the following:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Core/developed technology	$18,354	$17,456	$51,966	$51,812
Customer relationships	5,816	5,352	16,655	16,088
Contract rights intangible	7,913	9,076	22,719	27,624
Covenants not to compete	17	33	50	99
Trademarks and trade names	709	363	1,600	1,333
Capitalized software development costs(1)	906	812	2,655	2,398
Total	$33,715	$33,092	$95,645	$99,354

(1) Amortization of capitalized software development costs is included in cost of license revenue in the unaudited condensed consolidated statements of operations.

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The following table presents the estimated future amortization of intangible assets:

Fiscal Year	(in thousands)
Remainder of fiscal 2014	$32,855
2015	120,485
2016	83,359
2017	47,607
2018	33,687
2019 and thereafter	46,336
IPR&D(1)	3,087
Total	$367,416

(1) IPR&D projects are estimated to be completed within one year as of July 31, 2014. Assets are amortized over their useful life upon completion of the project or are written off upon abandonment.

Note 5. Financial Assets and Liabilities

Non-marketable equity securities. The Company's strategic investment portfolio consists of non-marketable equity securities in privately-held companies. The securities accounted for under cost method investments are reported at cost net of impairment losses. Securities accounted for under equity method investments are recorded at cost plus the proportional share of the issuers' income or loss, which is recorded in the Company's other income (expense), net. The cost basis of securities sold is based on the specific identification method. Refer to Note 6. Fair Value Measures.

Derivatives. In accordance with ASC 815, Derivatives and Hedging, the Company recognizes derivative instruments as either assets or liabilities in the unaudited condensed consolidated financial statements at fair value and provides qualitative and quantitative disclosures about such derivatives. The Company operates internationally and is exposed to potentially adverse movements in foreign currency exchange rates. The Company enters into hedges in the form of foreign currency forward contracts to reduce its exposure to foreign currency rate changes on non-functional currency denominated forecasted transactions and balance sheet positions including: (1) certain assets and liabilities, (2) shipments forecasted to occur within approximately one month, (3) future billings and revenue on previously shipped orders, and (4) certain future intercompany invoices denominated in foreign currencies.

The duration of forward contracts ranges from approximately one month to 21 months, the majority of which are short-term. The Company does not use foreign currency forward contracts for speculative or trading purposes. The Company enters into foreign exchange forward contracts with high credit quality financial institutions that are rated 'A' or above and to date has not experienced nonperformance by counterparties. Further, the Company anticipates continued performance by all counterparties to such agreements.

The assets or liabilities associated with the forward contracts are recorded at fair value in other current assets or accrued liabilities in the unaudited condensed consolidated balance sheets. The accounting for gains and losses resulting from changes in fair value depends on the use of the foreign currency forward contract and whether it is designated and qualifies for hedge accounting.

Cash Flow Hedging Activities

Certain foreign exchange forward contracts are designated and qualify as cash flow hedges. These contracts have durations of approximately 21 months or less. Certain forward contracts are rolled over periodically to capture the full length of exposure to the Company's foreign currency risk, which can be up to three years. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on the hedged transactions. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of other comprehensive income (OCI), in stockholders' equity and reclassified into revenue or operating expenses, as appropriate, at the time the hedged transactions affect earnings. We expect a majority of the hedge balance in OCI to be reclassified to the statements of operations within the next twelve months.

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Hedging effectiveness is evaluated monthly using spot rates, with any gain or loss caused by hedging ineffectiveness recorded in other income (expense), net. The premium/discount component of the forward contracts is recorded to other income (expense), net, and is not included in evaluating hedging effectiveness.

Non-designated Hedging Activities

The Company's foreign exchange forward contracts that are used to hedge non-functional currency denominated balance sheet assets and liabilities are not designated as hedging instruments. Accordingly, any gains or losses from changes in the fair value of the forward contracts are recorded in other income (expense), net. The gains and losses on these forward contracts generally offset the gains and losses associated with the underlying assets and liabilities, which are also recorded in other income (expense), net. The duration of the forward contracts for hedging the Company's balance sheet exposure is approximately one month.

The Company also has certain foreign exchange forward contracts for hedging certain international revenues and expenses that are not designated as hedging instruments. Accordingly, any gains or losses from changes in the fair value of the forward contracts are recorded in other income (expense), net. The gains and losses on these forward contracts generally offset the gains and losses associated with the foreign currency in operating income. The duration of these forward contracts is usually less than one year. The overall goal of the Company's hedging program is to minimize the impact of currency fluctuations on its net income over its fiscal year.

The effects of the changes in the fair values of non-designated forward contracts are summarized as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Gain (loss) recorded in other income (expense), net	$(53)	$(586)	$(667)	$3,344

The notional amounts in the table below for derivative instruments provide one measure of the transaction volume outstanding:

	As of July 31, 2014	As of October 31, 2013
	(in thousands)	
Total gross notional amount	$701,725	$746,801
Net fair value	$3,009	$7,199

The notional amounts for derivative instruments do not represent the amount of the Company's exposure to market gain or loss. The Company's exposure to market gain or loss will vary over time as a function of currency exchange rates. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The following represents the unaudited condensed consolidated balance sheet location and amount of derivative instrument fair values segregated between designated and non-designated hedge instruments:

	Fair Values of derivative instruments designated as hedging instruments	Fair Values of derivative instruments not designated as hedging instruments
	(in thousands)	
As of July 31, 2014		
Other current assets	$6,193	$159
Accrued liabilities	$3,247	$96
As of October 31, 2013		
Other current assets	$12,417	$20
Accrued liabilities	$5,103	$135

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The following table represents the unaudited condensed consolidated statement of operations location and amount of gains and losses on derivative instrument fair values for designated hedge instruments, net of tax:

	Location of gain (loss) recognized in OCI on derivatives	Amount of gain (loss) recognized in OCI on derivatives (effective portion)	Location of gain (loss) reclassified from OCI	Amount of gain (loss) reclassified from OCI (effective portion)
	(in thousands)			
Three months ended July 31, 2014				
Foreign exchange contracts	Revenue	$ (40)	Revenue	$ 1,563
Foreign exchange contracts	Operating expenses	(815)	Operating expenses	977
Total		$ (855)		$ 2,540
Three months ended July 31, 2013				
Foreign exchange contracts	Revenue	$ (158)	Revenue	$ 3,771
Foreign exchange contracts	Operating expenses	(2,106)	Operating expenses	(30)
Total		$ (2,264)		$ 3,741
Nine months ended July 31, 2014				
Foreign exchange contracts	Revenue	$ 3,324	Revenue	$ 3,237
Foreign exchange contracts	Operating expenses	(1,707)	Operating expenses	1,736
Total		$ 1,617		$ 4,973
Nine months ended July 31, 2013				
Foreign exchange contracts	Revenue	$ 2,701	Revenue	$ 6,325
Foreign exchange contracts	Operating expenses	(1,165)	Operating expenses	(854)
Total		$ 1,536		$ 5,471

The following table represents the ineffective portions and portions excluded from effectiveness testing of the hedge gains (losses) for derivative instruments designated as hedging instruments, which are recorded in other income (expense), net:

Foreign exchange contracts	Amount of gain (loss) recognized in income statement on derivatives (ineffective portion)(1)	Amount of gain (loss) recognized in income statement on derivatives (excluded from effectiveness testing)(2)
	(in thousands)	
For the three months ended July 31, 2014	$ 24	$ 548
For the three months ended July 31, 2013	$ 90	$ 260
For the nine months ended July 31, 2014	$ 57	$ 2,950
For the nine months ended July 31, 2013	$ 256	$ 1,522

(1) The ineffective portion includes forecast inaccuracies.
(2) The portion excluded from effectiveness testing includes the discount earned or premium paid for the contracts.

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Note 6. Fair Value Measures

ASC 820-10, Fair Value Measurements and Disclosures, defines fair value, establishes guidelines and enhances disclosure requirements for fair value measurements. The accounting guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The accounting guidance also establishes a fair value hierarchy based on the independence of the source and objective evidence of the inputs used. There are three fair value hierarchies based upon the level of inputs that are significant to fair value measurement:

Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical instruments in active markets;

Level 2—Observable inputs other than quoted prices included in Level 1 for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-driven valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3—Unobservable inputs to the valuation derived from fair valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

On a recurring basis, the Company measures the fair value of certain of its assets and liabilities, which include cash equivalents, non-qualified deferred compensation plan assets, foreign currency derivative contracts and contingent consideration associated with business combinations.

The Company's cash equivalents are classified within Level 1 or Level 2 because they are valued using quoted market prices in an active market or alternative independent pricing sources and models utilizing market observable inputs.

The Company's non-qualified deferred compensation plan assets consist of money market and mutual funds invested in domestic and international marketable securities that are directly observable in active markets and are therefore classified within Level 1.

The Company's foreign currency derivative contracts are classified within Level 2 because these contracts are not actively traded and the valuation inputs are based on quoted prices and market observable data of similar instruments.

The Company's borrowings under its credit and term loan facilities are classified within Level 2 because these borrowings are not actively traded and have a variable interest rate structure based upon market rates currently available to the Company for debt with similar terms and maturities. Refer to Note 8. Credit Facility.

The Company's liabilities for contingent consideration are classified within Level 3 because these valuations are based on management assumptions including discount rates and estimated probabilities of achievement of certain milestones which are unobservable in the market. As of July 31, 2014, the Company did not have any outstanding contingent consideration liability and as of October 31, 2013, the fair value of contingent consideration liability was estimated at $0.5 million.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below as of July 31, 2014:

Description	Total	Fair Value Measurement Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Assets				
Cash equivalents:				
Money market funds	$439,248	$439,248	$—	$ —
Prepaid and other current assets:				
Foreign currency derivative contracts	6,352	—	6,352	—
Other long-term assets:				
Deferred compensation plan assets	141,933	141,933	—	—
Total assets	$587,533	$581,181	$6,352	$ —
Liabilities				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	$3,343	$—	$3,343	$ —
Total liabilities	$3,343	$—	$3,343	$ —

Assets and liabilities measured at fair value on a recurring basis are summarized below as of October 31, 2013:

Description	Total	Fair Value Measurement Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)			
Assets				
Cash equivalents:				
Money market funds	$552,470	$552,470	$—	$ —
Prepaid and other current assets:				
Foreign currency derivative contracts	12,437	—	12,437	—
Other long-term assets:				
Deferred compensation plan assets	126,621	126,621	—	—
Total assets	$691,528	$679,091	$12,437	$ —
Liabilities				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	$5,238	$—	$5,238	$ —
Contingent consideration	493	—	—	493
Total liabilities	$5,731	$—	$5,238	$ 493

Assets/Liabilities Measured at Fair Value on a Non-Recurring Basis

Non-Marketable Equity Securities

Equity investments in privately-held companies, also called non-marketable equity securities are accounted for using either the cost or equity method of accounting.

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These equity investments are classified within Level 3 as they are valued using significant unobservable inputs or data in an inactive market, and the valuation requires management judgment due to the absence of market price and inherent lack of liquidity. The non-marketable equity securities are measured and recorded at fair value when an event or circumstance which impacts the fair value of these securities indicates an other-than-temporary decline in value has occurred. The Company monitors these investments and generally uses the income approach to assess impairments based primarily on the financial conditions of these companies.
The Company did not recognize any impairment during the three and nine months ended July 31, 2014 and 2013, respectively.
As of July 31, 2014, the fair value of the Company's non-marketable securities was $11.1 million, of which $6.7 million and $4.4 million were accounted for under the cost method and equity method, respectively. As of October 31, 2013, the fair value of non-marketable securities was $11.5 million, of which $6.9 million and $4.6 million were accounted for under the cost method and equity method, respectively. During the nine months ended July 31, 2014, the Company received a cash distribution of $6.6 million from the liquidation of one of its investments with a cost basis of $0.2 million resulting in a $6.4 million gain, which was recorded to other income (expense), net.

Note 7. Liabilities

Accounts payable and accrued liabilities consist of:

	July 31, 2014	October 31, 2013
	(in thousands)	
Payroll and related benefits	$258,835	$302,374
Other accrued liabilities	45,577	47,248
Accounts payable	14,624	8,575
Total	$319,036	$358,197

Other long-term liabilities consist of:

	July 31, 2014	October 31, 2013
	(in thousands)	
Deferred compensation liability	$141,933	$126,621
Other long-term liabilities	22,818	38,318
Total	$164,751	$164,939

Note 8. Credit Facility

On February 17, 2012, the Company entered into an agreement with several lenders (the Credit Agreement) providing for (i) a $350.0 million senior unsecured revolving credit facility (the Revolver) and (ii) a $150.0 million senior unsecured term loan facility (the Term Loan). Principal payments on a portion of the Term Loan are due in equal quarterly installments of $7.5 million, with the remainder due when the Credit Agreement expires in October 2016. The Company can elect to make prepayments on the Term Loan, in whole or in part, without premium or penalty. Subject to obtaining additional commitments from lenders, the principal amount of the loans provided under the Credit Agreement may be increased by the Company by up to an additional $150.0 million through October 13, 2015. The Credit Agreement contains financial covenants requiring the Company to operate within a maximum leverage ratio and maintain specified levels of cash, as well as other non-financial covenants.
During the second quarter of fiscal 2014, the Company drew down $200.0 million under the Revolver to finance a portion of the purchase price for the acquisition of Coverity on March 24, 2014. During the three month period ended July 31, 2014, the Company made principal payments of $200.0 million and $7.5 million under the Revolver and Term Loan, respectively. As of July 31, 2014, the Company had an $82.5 million outstanding balance under the Term Loan, of which $52.5 million is classified as long-term, and no outstanding balance under the Revolver. As of October 31, 2013, the Company had a $105.0 million outstanding balance under the Term Loan, of which $75.0 million was classified as long-term, and no outstanding balance under the Revolver. Borrowings bear interest at a floating rate based on a margin over the Company's choice of market observable base rates as defined in the Credit Agreement. At July 31, 2014, borrowings under the Term Loan bore interest at LIBOR +1.125% and the applicable

interest rate for the Revolver was LIBOR +0.975%. In addition, commitment fees are payable on the

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Revolver at rates between 0.150% and 0.300% per year based on the Company's leverage ratio on the daily amount of the revolving commitment.

These borrowings under the Credit Agreement have a variable interest rate structure and are classified within Level 2 of the fair value hierarchy. The carrying amount of the short-term and long-term debt approximates the estimated fair value.

As a result of the Coverity acquisition, the Company assumed Coverity's credit facility with a U.S. bank that had an original expiration date of December 31, 2014. The facility provided a maximum borrowing limit of $7.0 million. During the third quarter of fiscal 2014, the Company chose to terminate the Coverity credit facility prior to the original expiration date.

Note 9. Accumulated Other Comprehensive Income (Loss)

Components of accumulated other comprehensive income (loss), on an after-tax basis where applicable, were as follows:

	July 31, 2014	October 31, 2013
	(in thousands)	
Cumulative currency translation adjustments	$(36,350)	$(26,848)
Unrealized gain (loss) on derivative instruments, net of taxes	(5,162)	(1,847)
Total accumulated other comprehensive income (loss)	$(41,512)	$(28,695)

The effect of amounts reclassified out of each component of accumulated other comprehensive income (loss) into net income was as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Reclassifications from accumulated other comprehensive income (loss) into unaudited condensed consolidated statement of operations:				
Gain (loss) on cash flow hedges, net of taxes				
Revenues	$1,563	$3,771	$3,237	$6,325
Operating expenses	977	(30)	1,736	(854)
Total reclassifications into net income	$2,540	$3,741	$4,973	$5,471

Note 10. Stock Repurchase Program

The Company's Board of Directors (Board) previously approved a stock repurchase program pursuant to which the Company was authorized to purchase up to $500.0 million of its common stock, and has periodically replenished the stock repurchase program to such amount. The Board replenished the stock repurchase program up to $500.0 million on December 3, 2013, as announced on December 4, 2013. The program does not obligate Synopsys to acquire any particular amount of common stock, and the program may be suspended or terminated at any time by Synopsys' Chief Financial Officer or the Board. The Company repurchases shares to offset dilution caused by ongoing stock issuances from existing equity plans for equity compensation awards and issuances related to acquisitions, and when management believes it is a good use of cash. Repurchases are transacted in accordance with Rule 10b-18 of the Securities Exchange Act of 1934 (Exchange Act) and may be made through any means including, but not limited to, open market purchases, plans executed under Rule 10b5-1(c) of the Exchange Act and structured transactions. As of July 31, 2014, $420.3 million remained available for further repurchases under the program.

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Stock repurchase activities are as follow:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands, except per share price)			
Shares repurchased	—	970	2,050	1,973
Average purchase price per share	$—	$36.10	$38.90	$35.49
Aggregate purchase price	$—	$35,000	$79,747	$69,999
Reissuance of treasury stock	931	1,712	3,519	5,422

Note 11. Stock Compensation

The compensation cost recognized in the unaudited condensed consolidated statements of operations for the Company's stock compensation arrangements was as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Cost of license	$2,176	$1,566	$5,952	$4,872
Cost of maintenance and service	684	366	1,646	1,210
Research and development expense	10,126	8,114	28,037	23,655
Sales and marketing expense	4,696	3,454	12,394	10,339
General and administrative expense	3,717	2,990	10,312	9,643
Stock compensation expense before taxes	21,399	16,490	58,341	49,719
Income tax benefit	(4,905)	(4,035)	(13,372)	(12,166)
Stock compensation expense after taxes	$16,494	$12,455	$44,969	$37,553

As of July 31, 2014, there was $155.6 million of unamortized share-based compensation expense, which is expected to be amortized over a weighted-average period of approximately 2.7 years.

The intrinsic values of equity awards exercised during the periods are as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Intrinsic value of awards exercised	$3,709	$12,899	$23,556	$34,764

Note 12. Net Income per Share

The Company computes basic net income per share by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income per share reflects the dilution from potential common shares outstanding, such as stock options and unvested restricted stock units and awards, during the period using the treasury stock method.

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The table below reconciles the weighted-average common shares used to calculate basic net income per share with the weighted-average common shares used to calculate diluted net income per share:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Numerator:				
Net income	$65,656	$52,297	$196,669	$190,910
Denominator:				
Weighted-average common shares for basic net income per share	155,194	153,915	154,611	152,969
Dilutive effect of potential common shares from equity-based compensation	2,428	3,141	2,642	3,246
Weighted-average common shares for diluted net income per share	157,622	157,056	157,253	156,215
Net income per share:				
Basic	$0.42	$0.34	$1.27	$1.25
Diluted	$0.42	$0.33	$1.25	$1.22
Anti-dilutive employee stock-based awards excluded(1)	2,875	1,648	2,057	2,179

(1) These stock options and unvested restricted stock units and restricted stock awards were anti-dilutive for the respective periods and are excluded in calculating diluted net income per share. While such awards were antidilutive for the respective periods, they could be dilutive in the future.

Note 13. Segment Disclosure

ASC 280, Segment Reporting, requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. Segment reporting is based upon the “management approach,” i.e., how management organizes the Company’s operating segments for which separate financial information is (1) available and (2) evaluated regularly by the Chief Operating Decision Makers (CODMs) in deciding how to allocate resources and in assessing performance. Synopsys’ CODMs are the Company’s two Co-Chief Executive Officers.

The Company operates in a single segment to provide software products and consulting services in the EDA software industry. In making operating decisions, the CODMs primarily consider consolidated financial information, accompanied by disaggregated information about revenues by geographic region. Specifically, the CODMs consider where individual “seats” or licenses to the Company’s products are located in allocating revenue to particular geographic areas. Revenue is defined as revenues from external customers. Goodwill is not allocated since the Company operates in one reportable operating segment. Revenues related to operations in the United States and other geographic areas were:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Revenue:				
United States	$268,228	$234,770	$745,458	$706,083
Europe	65,881	68,591	203,645	197,712
Japan	61,517	64,874	184,219	200,510
Asia-Pacific and Other	126,186	114,710	385,138	353,034
Consolidated	$521,812	$482,945	$1,518,460	$1,457,339

Geographic revenue data for multi-region, multi-product transactions reflect internal allocations and are therefore subject to certain assumptions and the Company's methodology.

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One customer accounted for 10.5% and 11.5% of the Company's unaudited condensed consolidated revenue in the three months ended July 31, 2014 and 2013, respectively, and accounted for 10.7% and 11.4% of the Company's unaudited condensed consolidated revenue in the nine months ended July 31, 2014 and 2013, respectively.

Note 14. Other Income (Expense), net

The following table presents the components of other income (expense), net:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Interest income	$294	$301	$975	$1,563
Interest expense	(715)	(404)	(1,654)	(1,325)
Gain (loss) on assets related to executive deferred compensation plan	3,069	2,841	7,529	12,511
Foreign currency exchange gain (loss)	80	217	865	6,127
Other, net(1)	816	222	11,082	2,254
Total	$3,544	$3,177	$18,797	$21,130

(1) Refer to Note 6. Fair Value Measures.

Note 15. Taxes

Effective Tax Rate

The Company estimates its annual effective tax rate at the end of each fiscal quarter. The Company's estimate takes into account estimations of annual pre-tax income, the geographic mix of pre-tax income and the Company's interpretations of tax laws and possible outcomes of audits.

The following table presents the provision for income taxes and the effective tax rates:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)		(in thousands)	
Income before income taxes	$70,771	$58,172	$210,014	$216,609
Provision (benefit) for income tax	$5,115	$5,875	$13,345	$25,699
Effective tax rate	7.2%	10.1%	6.4%	11.9%

The Company's effective tax rate for the three and nine months ended July 31, 2014 is lower than the statutory federal income tax rate of 35% primarily due to the lower tax rates applicable to its non-U.S. operations, U.S. federal and California research tax credits, settlements with U.S. and Taiwan tax authorities, and statutes of limitations lapses, partially offset by state taxes and non-deductible stock compensation.

The effective tax rate decreased in the three months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to statutes of limitations lapses that resulted in the recognition of an unrecognized tax benefit. The effective tax rate decreased in the nine months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to the benefit of audit settlements with the Internal Revenue Service (IRS) and Taiwan in the first and second quarter of fiscal 2014, respectively, statutes of limitations lapses in the third quarter of fiscal 2014, and changes in geographical earnings mix, partially offset by the reinstatement of the research tax credit and the reversal of deferred taxes resulting from the merger of a foreign affiliate in the first quarter of fiscal 2013.

The Company's total gross unrecognized tax benefits at July 31, 2014 are $102.9 million exclusive of interest and penalties. If the total gross unrecognized tax benefits at July 31, 2014 were recognized in the future, approximately $99.3 million would decrease the effective tax rate.

The timing of the resolution of income tax examinations is highly uncertain as well as the amounts and timing of various tax payments that are part of the settlement process. This could cause large fluctuations in the balance

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sheet classification of current and non-current assets and liabilities. The Company believes that in the coming 12 months, it is reasonably possible that either certain audits will conclude or the statute of limitations on certain state and foreign income and withholding taxes will expire, or both. Given the uncertainty as to ultimate settlement terms, the timing of payment and the impact of such settlements on other uncertain tax positions, the range of the estimated potential decrease in underlying unrecognized tax benefits is between $0 and $23 million.

IRS Examinations

On November 6, 2013, the Company reached final settlement with the IRS on the remaining fiscal 2012 issues and recognized approximately $10 million in unrecognized tax benefits in the first quarter of fiscal 2014.

Non-U.S. Examinations

On February 11, 2014 and April 1, 2014 the Company reached settlements with the Taiwan tax authorities for fiscal 2010 and 2009, respectively, with regard to certain transfer pricing issues. As a result of the settlements and the application of the settlement to other open fiscal years, the Company’s unrecognized tax benefits decreased by $5.1 million. The net tax benefit resulting from the settlements and the application to other open fiscal years was $3.9 million.

Note 16. Effect of New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)," which supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605).” This ASU requires an entity to recognize revenue when goods are transferred or services are provided to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. This ASU also requires disclosures enabling users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance will be effective for fiscal 2018, including interim periods within that reporting period, using one of two prescribed retrospective methods, and no early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which are subject to the "safe harbor" created by those sections. Any statements herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as "may," "will," "could," "would," "should," "anticipate," "expect," "intend," "believe," "estimate," "project" or "continue," and such terms are intended to identify forward-looking statements. Without limiting the foregoing, forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements concerning expected growth in the semiconductor industry, our business outlook, the ability of our prior acquisitions (including our acquisition of Coverity, Inc.) to drive revenue growth, the sufficiency of our cash and cash equivalents and cash generated from operations, and our future liquidity requirements, and other statements that involve certain known and unknown risks, uncertainties and other factors that could cause our actual results, time frames or achievements to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those identified below in Part II, Item 1A. Risk Factors of this Form 10-Q. The information included herein represents our estimates and assumptions as of the date of this filing. Unless required by law, we undertake no obligation to update publicly any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future. All subsequent written or oral forward-looking statements attributable to Synopsys or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Readers are urged to carefully review and consider the various disclosures made in this report and in other documents we file from time to time with the Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect our business.

The following summary of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this report and with our audited consolidated financial statements and the related notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, as filed with the SEC on December 20, 2013.

Overview

Business Summary

Synopsys is a global leader in providing software, intellectual property and services used to design integrated circuits and electronic systems. We supply the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. We also offer intellectual property (IP) products, which are pre-designed circuits that engineers use as components of larger chip designs rather than designing those circuits themselves. We provide software and hardware used to develop the systems that incorporate chips and the software that runs on them. To complement these product offerings, we provide technical services to support our solutions and we help our customers develop chips and electronic systems. We are also a leading provider of software tools that developers use to improve the quality and time-to-market of software code in a wide variety of industries, including electronics, financial services, energy, and industrials.

Our EDA and IP customers are generally semiconductor and electronics systems companies. Our solutions help them overcome the challenge of developing increasingly advanced electronics products while reducing their design and manufacturing costs. While our products are an important part of our customers' development process, our customers' research and development budget and spending decisions may be affected by their business outlook and their willingness to invest in new and increasingly complex chip designs.

Despite global economic uncertainty, we have maintained profitability and positive cash flow on an annual basis in recent years. We achieved these results not only because of our solid execution, leading technology and strong customer relationships, but also because of our time-based revenue business model. Under this model, a substantial majority of our customers pay for their licenses over time and we typically recognize this revenue over the life of the contract, which averages approximately three years. Time-based revenue, which consists of time-based license, maintenance and service revenue, generally represents approximately 90% of our total revenue. The revenue we

recognize in a particular period generally results from selling efforts in prior periods rather than the current period. Due to our business model, decreases as well as increases in customer spending do not immediately affect our revenues in a significant way.

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As we continue to expand our product portfolio and our total addressable market, for instance in IP products, we may experience increased variability in our revenue, though we expect time-based revenue to continue to generally represent approximately 90% of our total revenue. Overall, our business outlook remains solid based on our leading technology, customer relationships, business model, diligent expense management, and acquisition strategy. We believe that these factors will help us continue to successfully execute our strategies.

Acquisition of Coverity

On March 24, 2014, we acquired Coverity, Inc. (Coverity) the leading provider of software quality, testing and security tools. We believe this acquisition has enabled us to enter into a new, growing market dedicated to helping companies deliver better software faster, by finding software code defects as the code is being developed rather than at the end of the process. Coverity's customer base includes Synopsys' semiconductor and systems customers, albeit different users and budgets, and extends well beyond to software developers such as independent software vendors and companies engaged in e-commerce. We believe the Coverity acquisition has expanded our total addressable market. However, due to the fair value adjustment of acquired deferred revenue and amortization of intangible assets, the acquisition will have a negative effect on net income in the short term. We report revenue from our Coverity software quality, testing and security tools in our IP and Software Solutions group, which we previously referred to as IP and System-Level Solutions.

Financial Performance Summary for the Three Months Ended July 31, 2014 (Compared to the Three Months Ended July 31, 2013)

- Net income of $65.7 million for the quarter was 26% higher compared to the same period in fiscal 2013 due to our overall growth and acquisitions, which increased our revenue by 8%, while our expenses increased by 6%.
- We repaid our senior unsecured revolving credit facility balance of $200.0 million.
- Our cash flow from operations increased by 24% primarily due to higher cash collections.
- We continued to derive more than 90% of our revenue from time-based revenue.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)," which supersedes nearly all existing revenue recognition guidance under U.S. generally accepted accounting principles (GAAP). The new guidance will be effective for fiscal 2018, including interim periods within that reporting period, using one of two prescribed retrospective methods. No early adoption is permitted. We are currently in the process of evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements and related disclosures.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial results under the heading "Results of Operations" below are based on our unaudited condensed consolidated financial statements, which we have prepared in accordance with GAAP. In preparing these financial statements, we make assumptions, judgments and estimates that can affect the reported amounts of assets, liabilities, revenues and expenses and net income. On an on-going basis, we evaluate our estimates based on historical experience and various other assumptions we believe are reasonable under the circumstances. Our actual results may differ from these estimates.

The accounting policies that most frequently require us to make assumptions, judgments and estimates, and therefore are critical to understanding our results of operations, are:

- Revenue recognition;
- Valuation of stock compensation;
- Valuation of intangible assets; and
- Income taxes.

Our critical accounting policies and estimates are discussed in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, filed with the SEC on December 20, 2013.

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Results of Operations

Revenue Background

We generate our revenue from the sale of software licenses, maintenance and professional services and, to a small extent, hardware products. With respect to software licenses, we utilize three license types:

- Technology Subscription Licenses (TSLs). TSLs are time-based licenses for a finite term, and generally provide the customer limited rights to receive, or to exchange certain quantities of licensed software for, unspecified future technology. We bundle and do not charge separately for post-contract customer support (maintenance) for the term of the license.
- Term licenses. Term licenses are also for a finite term, but do not provide the customer any rights to receive, or to exchange licensed software for, unspecified future technology. Customers purchase maintenance separately for the first year and may renew annually for the balance of the term. The annual maintenance fee is typically calculated as a percentage of the net license fee.
- Perpetual licenses. Perpetual licenses continue as long as the customer renews maintenance plus an additional 20 years. Perpetual licenses do not provide the customer any rights to receive, or to exchange licensed software for, unspecified future technology. Customers purchase maintenance separately for the first year and may renew annually.

For the three software license types, we recognize revenue as follows:

- TSLs. We typically recognize revenue from TSL fees (which include bundled maintenance) ratably over the term of the license period, or as customer installments become due and payable, whichever is later. Revenue attributable to TSLs is reported as “time-based license revenue” in the unaudited condensed consolidated statements of operations.
- Term licenses. We recognize revenue from term licenses in full upon shipment of the software if payment terms require the customer to pay at least 75% of the license fee and 100% of the maintenance fee within one year from shipment and all other revenue recognition criteria are met. Revenue attributable to these term licenses is reported as “upfront license revenue” in the unaudited condensed consolidated statements of operations. For term licenses in which less than 75% of the license fee and 100% of the maintenance fee is payable within one year from shipment, we recognize revenue as customer payments become due and payable. Such revenue is reported as “time-based license revenue” in the unaudited condensed consolidated statements of operations.
- Perpetual licenses. We recognize revenue from perpetual licenses in full upon shipment of the software if payment terms require the customer to pay at least 75% of the license fee and 100% of the maintenance fee within one year from shipment and all other revenue recognition criteria are met. Revenue attributable to these perpetual licenses is reported as “upfront license revenue” in the unaudited condensed consolidated statements of operations. For perpetual licenses in which less than 75% of the license fee and 100% of the maintenance fee is payable within one year from shipment, we recognize revenue as customer installments become due and payable. Such revenue is reported as “time-based license revenue” in the unaudited condensed consolidated statements of operations.

We recognize revenue from orders we receive for software licenses, services and hardware products at varying times. In most instances, we recognize revenue on a TSL software license order over the license term and on a term or perpetual software license order in the quarter in which the license is delivered. The weighted average license term of the TSLs and term licenses we entered into for the three months ended July 31, 2014 and 2013 was 3.1 and 2.9 years, respectively. Revenue on contracts requiring significant modification or development is accounted for using the percentage of completion method over the period of the development. Revenue on hardware product orders is generally recognized in full at the time the product is shipped. Contingent revenue is recognized if and when the applicable event occurs.

Revenue on maintenance orders is recognized ratably over the maintenance period (normally one year). Revenue on professional services orders is generally recognized after services are performed and accepted by the customer.

Our revenue in any period is equal to the sum of our time-based license, upfront license, maintenance and professional services for the period. We derive time-based license revenue largely from TSL orders received and delivered in prior quarters and to a smaller extent due to contracts in which revenue is recognized as customer installments become due and payable and from contingent revenue arrangements. We derive upfront license revenue directly from term and perpetual license and hardware product orders mostly booked and shipped during

the period. We derive maintenance revenue largely from maintenance orders received in prior periods since our maintenance orders generally yield revenue ratably over a term of one year. We also derive professional services revenue primarily from orders received in prior quarters, since we recognize revenue from professional services as those services are delivered and accepted or on percentage of completion for arrangements requiring significant modification of our software, and not when they are booked. Our license revenue is sensitive to the mix of TSLs and perpetual or term licenses delivered during a reporting period. A TSL order typically yields lower current quarter revenue but contributes to revenue in future periods. For example, a $120,000 order for a three-year TSL delivered on the last day of a quarter typically generates no revenue in that quarter, but $10,000 in each of the twelve succeeding quarters. Conversely, a $120,000 order for perpetual and term licenses with greater than 75% of the license fee due within one year from shipment typically generates $120,000 in revenue in the quarter the product is delivered, but no future revenue. Additionally, revenue in a particular quarter may also be impacted by perpetual and term licenses in which less than 75% of the license fees and 100% of the maintenance fees are payable within one year from shipment as the related revenue will be recognized as revenue in the period when customer payments become due and payable.
Our customer arrangements are complex, involving hundreds of products and various license rights, and our customers bargain with us over many aspects of these arrangements. For example, they often demand a broader portfolio of solutions, support and services and seek more favorable terms such as expanded license usage, future purchase rights and other unique rights at an overall lower total cost. No single factor typically drives our customers' buying decisions, and we compete on all fronts to serve customers in a highly competitive EDA market. Customers generally negotiate the total value of the arrangement rather than just unit pricing or volumes.

Total Revenue

	July 31,			
	2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended	$521.8	$482.9	$38.9	8 %
Nine months ended	$1,518.5	$1,457.3	$61.2	4 %

Our revenues are subject to fluctuations, primarily due to customer requirements, including payment terms and the timing and value of contract renewals. For example, we experience variability in our quarterly revenue due to factors such as the timing of renewals of maintenance contracts, timing of IP consulting projects and royalties, and certain contracts where revenue is recognized when customer installment payments are due, as well as volatility in hardware sales.
The increase in total revenue for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was due to our overall growth and increases in time-based license revenue, including contributions of revenue from acquired companies, and professional services and other revenue, which were partially offset by a decrease in our upfront license revenue.
The increase in total revenue for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was due to our overall growth and increases in time-based license revenue, including contributions of revenue from acquired companies, and upfront license revenue, which were partially offset by a decrease in our professional services and other revenue.

Time-Based License Revenue

	July 31,			
	2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended	$431.2	$387.1	$44.1	11 %
Percentage of total revenue	83 %	80 %		
Nine months ended	$1,255.5	$1,186.5	$69.0	6 %
Percentage of total revenue	83 %	81 %		

The increase in time-based license revenue for the three and nine months ended July 31, 2014 compared to the same periods in fiscal 2013 was primarily attributable to an increase in TSL license revenue due to our overall growth, including contributions of revenue from acquired companies.

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Upfront License Revenue

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended	$31.6	$40.0	$(8.4)	(21)%
Percentage of total revenue	6%	8%		
Nine months ended	$101.9	$95.5	$6.4	7%
Percentage of total revenue	7%	7%		

Changes in upfront license revenue are generally attributable to normal fluctuations in customer requirements, which can drive the amount of upfront orders and revenue in any particular period.

The decrease in upfront license revenue for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily attributable to a decrease in the sale of hardware products, which was partially offset by an increase in the sale of perpetual licenses to IP and Software Solutions products.

The increase in upfront license revenue for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily attributable to an increase in the sale of perpetual licenses to IP and Software Solutions products, which was partially offset by a decrease in the sale of hardware products.

Maintenance and Service Revenue

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended				
Maintenance revenue	$18.0	$19.1	$(1.1)	(6)%
Professional services and other revenue	41.0	36.8	4.2	11%
Total maintenance and service revenue	$59.0	$55.9	$3.1	6%
Percentage of total revenue	11%	12%		
Nine months ended				
Maintenance revenue	$56.1	$59.9	$(3.8)	(6)%
Professional services and other revenue	105.0	115.4	(10.4)	(9)%
Total maintenance and service revenue	$161.1	$175.3	$(14.2)	(8)%
Percentage of total revenue	11%	12%		

Changes in maintenance revenue are generally attributable to timing and type of contracts that bundle maintenance.

The changes in professional services and other revenue for the three and nine months ended July 31, 2014 compared to the same periods in fiscal 2013 was primarily due to the timing of IP customization projects that are accounted for using the percentage of completion method.

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Cost of Revenue

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended				
Cost of license revenue	$68.5	$69.9	$(1.4)	(2)%
Cost of maintenance and service revenue	20.7	19.2	1.5	8%
Amortization of intangible assets	26.3	26.5	(0.2)	(1)%
Total	$115.5	$115.6	$(0.1)	—%
Percentage of total revenue	22%	24%		
Nine months ended				
Cost of license revenue	$198.7	$195.9	$2.8	1%
Cost of maintenance and service revenue	62.1	59.1	3.0	5%
Amortization of intangible assets	74.7	79.4	(4.7)	(6)%
Total	$335.5	$334.4	$1.1	—%
Percentage of total revenue	22%	23%		

We divide cost of revenue into three categories: cost of license revenue, cost of maintenance and service revenue, and amortization of intangible assets. We segregate expenses directly associated with consulting and training services from cost of license revenue associated with internal functions providing license delivery and post-customer contract support services. We then allocate these group costs between cost of license revenue and cost of maintenance and service revenue based on license and maintenance and service revenue reported.

Cost of license revenue. Cost of license revenue includes costs related to products sold and software licensed, allocated operating costs related to product support and distribution costs, royalties paid to third party vendors, and the amortization of capitalized research and development costs associated with software products that have reached technological feasibility.

Cost of maintenance and service revenue. Cost of maintenance and service revenue includes operating costs related to maintaining the infrastructure necessary to operate our services and training organization, and costs associated with the delivery of our consulting services, such as hotline and on-site support, production services and documentation of maintenance updates.

Amortization of intangible assets. Amortization of intangible assets, which is recorded to cost of revenue and operating expenses, includes the amortization of certain contract rights and the amortization of core/developed technology, trademarks, trade names, customer relationships, and covenants not to compete related to acquisitions.

Cost of revenue for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was flat due to increases in (a) personnel-related costs of $5.9 million driven by higher headcount and (b) consultant and contractor costs of $1.5 million, being offset by lower product costs of $7.5 million, primarily due to lower hardware sales and purchase accounting adjustments that were recorded in fiscal 2013.

Cost of revenue for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 remained relatively flat, primarily due to increases in (a) personnel-related costs of $8.4 million driven by higher headcount and (b) $4.0 million in consultant and contractor costs, being offset by lower product costs of $6.6 million, primarily due to lower hardware sales, and purchase accounting adjustments that were recorded in fiscal 2013, and a decrease in amortization of intangible assets due to certain intangible assets being fully amortized.

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Operating Expenses
Research and Development

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended	$182.8	$166.7	$16.1	10 %
Percentage of total revenue	35 %	35 %		
Nine months ended	$528.4	$494.1	$34.3	7 %
Percentage of total revenue	35 %	34 %		

The increase in research and development expenses in the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to an increase of $12.8 million in personnel-related costs primarily as a result of headcount increases, including those from acquisitions, and functionally allocated expenses that were higher by $3.6 million.
The increase in research and development expenses for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to an increase of $22.4 million in personnel-related costs primarily as a result of headcount increases, including those from acquisitions, functionally allocated expenses that were higher by $8.9 million, and a $3.4 million increase in consultant and contractor costs.
Sales and Marketing

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended	$112.3	$105.4	$6.9	7 %
Percentage of total revenue	22 %	22 %		
Nine months ended	$332.8	$311.1	$21.7	7 %
Percentage of total revenue	22 %	21 %		

The increase in sales and marketing expenses in the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to an increase of $6.5 million in personnel-related costs as a result of headcount increases, including those from acquisitions.
The increase in sales and marketing expenses in the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to increases of $14.7 million in personnel-related costs as a result of headcount increases, including those from acquisitions, and $6.6 million in variable compensation due to higher shipments.

General and Administrative

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended	$37.4	$34.5	$2.9	8 %
Percentage of total revenue	7 %	7 %		
Nine months ended	$112.2	$104.7	$7.5	7 %
Percentage of total revenue	7 %	7 %		

The increase in general and administrative expenses for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to increases of $4.4 million in facilities and depreciation expenses and $2.4 million in personnel costs. The increases were partially offset by higher allocation of $5.3 million in expenses to other functions compared to the same period in fiscal 2013, resulting from increased headcount in other functions.

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The increase in general and administrative expenses for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to increases of $7.2 million in facilities and depreciation expenses, $5.5 million in professional service costs and $3.5 million of acquisition-related costs. In addition, bad debt expense decreased by $1.8 million compared to the same period in fiscal 2013 primarily due to larger increases in the bad debt reserve in the prior year. The increases were partially offset by higher allocations of $11.1 million in expenses to other functions compared to the same period in fiscal 2013, resulting from increased headcount in other functions.

Amortization of Intangible Assets

	July 31,			
	2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended				
Included in cost of revenue	$26.3	$26.5	$(0.2)	(1)%
Included in operating expenses	6.5	5.8	0.7	12%
Total	$32.8	$32.3	$0.5	2%
Percentage of total revenue	6%	7%		
Nine months ended				
Included in cost of revenue	$74.7	$79.4	$(4.7)	(6)%
Included in operating expenses	18.3	17.6	0.7	4%
Total	$93.0	$97.0	$(4.0)	(4)%
Percentage of total revenue	6%	7%		

Amortization of intangible assets for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was relatively flat as additions of intangible assets from our 2014 acquisitions were offset by certain intangible assets being fully amortized prior to the three months ended July 31, 2014.

The decrease in amortization of intangible assets for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was due to certain intangible assets being fully amortized prior to the three months ended July 31, 2014, partially offset by additions of intangible assets from our fiscal 2014 acquisitions. See Note 4 of the Notes to Unaudited Condensed Consolidated Financial Statements for a schedule of future amortization amounts.

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Other Income (Expense), net

	July 31, 2014	2013	$ Change	% Change
	(dollars in millions)			
Three months ended				
Interest income	$0.3	$0.3	$—	— %
Interest (expense)	(0.7)	(0.4)	(0.3)	75 %
Gain on assets related to executive deferred compensation plan assets	3.1	2.9	0.2	7 %
Foreign currency exchange gain	0.1	0.2	(0.1)	(50)%
Other, net	0.7	0.2	0.5	250 %
Total	$3.5	$3.2	$0.3	9 %
Nine months ended				
Interest income	$1.0	$1.5	$(0.5)	(33)%
Interest (expense)	(1.7)	(1.3)	(0.4)	31 %
Gain on assets related to executive deferred compensation plan assets	7.5	12.5	(5.0)	(40)%
Foreign currency exchange gain	0.9	6.1	(5.2)	(85)%
Other, net	11.1	2.3	8.8	383 %
Total	$18.8	$21.1	$(2.3)	(11)%

Other income (expense), net for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was flat.

Other income (expense), net for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was lower primarily due to decreased foreign currency exchange gains as a result of less movement in foreign currency exchange rates and lower gains in the market value of our executive deferred compensation plan assets. The aforementioned decreases were partially offset by a gain from the sale of a non-marketable equity investment in fiscal 2014 that was recorded in other, net.

Taxes

Our effective tax rate decreased in the three months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to statutes of limitations lapses that resulted in the recognition of an unrecognized tax benefit. The effective tax rate decreased in the nine months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to the benefit of audit settlements with the Internal Revenue Service and Taiwan in the first and second quarter of fiscal 2014, respectively, statutes of limitations lapses in the third quarter of fiscal 2014, and changes in geographical earnings mix, partially offset by the reinstatement of the research tax credit and the reversal of deferred taxes resulting from the merger of a foreign affiliate in the first quarter of fiscal 2013. For further discussion of the provision for income taxes, see Note 15 of the Notes to Unaudited Condensed Consolidated Financial Statements.

Liquidity and Capital Resources

Our sources of cash and cash equivalents are funds generated from our business operations and funds that may be drawn down under our revolving credit and term loan facilities.

As of July 31, 2014, we held an aggregate of $109.3 million in cash and cash equivalents in the United States and an aggregate of $793.7 million in our foreign subsidiaries. Funds held in our foreign subsidiaries are generated from revenue outside North America. At present, such foreign funds are considered to be indefinitely reinvested in foreign countries to the extent of indefinitely reinvested foreign earnings. However, in the event funds from foreign operations were needed to fund cash needs in the U.S. and if U.S. taxes have not already been previously accrued, we would be required to accrue and pay additional U.S. taxes in order to repatriate these funds.

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The following sections discuss changes in our unaudited condensed consolidated balance sheets and statements of cash flow, and other commitments of our liquidity and capital resources during the nine months ended July 31, 2014.

Cash and Cash Equivalents

	July 31, 2014	October 31, 2013	$ Change	% Change
	(dollars in millions)			
Cash and cash equivalents	$903.0	$1,022.4	$(119.4)	(12)%

Cash and cash equivalents decreased primarily due to our cash paid for acquisitions, treasury stock, and property and equipment during fiscal 2014, which were partially offset by the cash provided by our operating activities.

Cash Flows

	July 31, 2014